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NO TDS liability on software purchases on basis of retro-amendment in definition of 'royalty'

Summary – The Mumbai ITAT in a recent case of Reliance Industries Ltd., (the Assessee) held that To constitute "royalty" under India-USA DTAA, it is the consideration for transfer of "use of copyright in the work" and not the "use of work" itself. However, '*Explanation 4*' inserted under section 9(1)(vi) by the Finance Act, 2012, provides that the transfer of rights includes and has always included the right for use or right to use a computer software including granting of a license. Thus, it cannot be said that the definition of royalty under the Income Tax Act is in *paramateria* with that under the DTAA. Even otherwise, TDS liability does not arise on basis of retrospective amendment in definition of royalty

Facts

- The assessee had purchased software from residents of different countries for its business of oil and gas exploration. It made payment for such purchase without deducting tax at source.
- Assessing Officer was of the view *Explanation 4* has been inserted with retrospective effect in section 9(1)(vi) which specifically includes computer software in the definition of royalty. These payments would be liable for TDS deduction u/s 195. Thus, assessee to be treated as assessee-in-default.
- On appeal, the CIT(A) held that the payment made by the assessee for purchase of software would not amount to royalty.
- The aggrieved-revenue filed an instant appeal before the Tribunal.

The Tribunal Held in favour of assessee as under:

- A perusal of the definition of royalty as provided in Article 12 of the India-USA 'DTAA' reveals that it is the payment which is received as consideration for the 'use of' or the 'right to use' '**any copyright of literary, artistic, scientific work including….'(emphasis supplied)**
- Hence, what is relevant is the consideration paid 'for the use of' or the right 'to use' any 'copyright'. The right to use a computer software programme has not been specifically mentioned in the DTAA with any country
- However, '*Explanation 4*' inserted under section 9(1)(vi) by the Finance Act, 2012, provides that the transfer of rights in respect of any right, property or information includes and has always included the right for use or right to use a computer software including granting of a license.
- Under the circumstances, it cannot be said that the definition of royalty under the Income Tax Act is in *paramateria* with that under the DTAA. Since the definition provided under the royalty in the DTAA is more beneficial to the assessee, as per the provisions of section 90, the definition of royalty as provided under DTAA is to be taken.

- One has to understand the difference between the term "use of copy right in software"and "use of software" itself. To constitute "royalty" under DTAA, it is the consideration for transfer of "use of copyright in the work" and not the "use of work" itself.
- In our view the sale of a CD ROM/diskette containing software is not a license but it is a sale of a product which, of course, is a copyrighted product and the owner of the copyright by way of agreement puts the conditions and restrictions on the use of the product so that his copyrights in such copyrighted article or the work may not be infringed.
- The assessee could not be said to have paid the consideration for use of or the right to use copyright but had simply purchased the copyrighted work embedded in the CD-ROM which could be said to be sale of 'good' by the owner. The consideration paid by the assessee as per the clauses of the DTAA could not be said to be royalty and the same would be outside the scope of the definition of 'royalty' as provided in the DTAA.
- Amendment vide which the *Explanation 4* has been with retrospective effect to section 9(1)(vi) and has the effect of change in the law. By the introduction of the said *Explanation 4*, computer software has been specifically included in the definition of 'right, property or information' which was never assumed to have been included by any court of law prior to such insertion
- The assessee was under the *bonafide belief* that there was no liability to deduct tax in respect of the consideration paid for the said purchase of software. Hence, assessee was not supposed to deduct TDS on such purchases.